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No. 93-1651

In the Supreme Court of the United States

OCTOBER TERM, 1993

STUART K. PATRICK, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the Securities and Exchange Commission properly determined that a brokerage firm's president failed to discharge his supervisory duties reasonably when he neglected either to supervise or to delegate the responsibility for supervising a vice president who was conducting improper trades for the firm.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-7a) is reported at 19 F.3d 66. The decision of the Securities and Exchange Commission (Pet. App. 8a-20a, 21a) is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on January 19, 1994. The petition for a writ of certiorari was filed on April 19, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioner Stuart K. Patrick is the president and chief executive officer of Baird, Patrick & Co., Inc. (Baird, Patrick), a member of the New York Stock Exchange, Inc. (Exchange). Pet. App. 2a-3a. He contends that the court of appeals erred in affirming an order of the Securities and Exchange Commission that sustained disciplinary action taken against him by the Exchange based on a finding that he failed to exercise reasonable supervision over the securities trading activities of an employee, in violation of New York Stock Exchange Rule 342(a) (*reprinted at* Pet. App. 38a).[1] Pet. App. 5a.

1. a. As a national securities exchange registered with the Commission, the New York Stock Exchange is responsible for regulating its members and persons associated with its members. The Exchange is subject to comprehensive oversight by the Commission in performing those responsibilities. See 15 U.S.C. 78f(b) and 78s. Under Section 19(d)(2) and (e)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78s(d)(2) and (e)(1), disciplinary action taken by the Exchange is subject to review by the Commission. On review, the Commission considers the record *de novo* and makes its own findings as to whether the conduct in question violated the Exchange's rules. See 15 U.S.C. 78s(e)(1). The Commission's findings and order are then subject to judicial review. See 15 U.S.C. 78y(a); *R.H. Johnson & Co.* v. *SEC*,

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[1] Rule 342(a) provides, in relevant part:

> The person in charge of a group of employees shall reasonably discharge his duties and obligations in connection with supervision and control of the activities of those employees related to the business of their employer and compliance with securities laws and regulations.

198 F.2d 690, 694-695 (2d Cir.), cert. denied, 344 U.S. 855 (1952).

b. At the time of the events that led to petitioner's disciplinary proceeding, Christian G. Keller was a vice president of Baird, Patrick and the head of trading for that firm on the floor of the Exchange. Keller was also in charge of trading in Baird, Patrick's proprietary account. Under the firm's organizational structure, Keller reported only to petitioner or, in petitioner's absence, to the chairman of the board. Petitioner acknowledged that, as president and chief executive officer, he had overall supervisory responsibility for the firm's operations, and that he and the chairman were the persons at the firm who were responsible for internal supervision and control and for compliance with the securities laws. Pet. App. 3a, 9a-10a.

Between January and June 1988, Keller initiated more than 1,500 trades on the floor of the Exchange for Baird, Patrick's proprietary account in violation of rules designed to prevent Exchange members, when trading for their own accounts, from gaining an unfair advantage over brokerage customers.[2] Apart from a brief period when the proprietary account trading rules were first adopted in 1978, no one at Baird, Patrick monitored Keller's trading to ensure that he complied with the rules. In testimony before the Exchange, petitioner repeatedly emphasized that neither he nor anyone else at

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[2] Those rules implement 15 U.S.C. 78k(a)(1), which restricts the ability of an exchange member to effect trades on the exchange floor in an account in which the member has an interest. That Section is designed to allow any member on an exchange floor with a public order to claim precedence in execution over orders for the accounts of members or persons associated with members. See 15 U.S.C. 78k(a)(1); 17 C.F.R. 240.11a-1.

the firm supervised Keller. Pet. App. 10a-11a; C.A. App. 95.

2. a. The Exchange's Division of Enforcement charged petitioner with violating Exchange Rule 342(a) by failing to discharge his duties and obligations reasonably in connection with the supervision and control of Keller's trading activities. Pet. App. 32a-34a. An Exchange hearing panel found that petitioner was not responsible for the failure to supervise Keller. *Id.* at 28a-31a. On review, however, the Exchange's Board of Directors reversed the panel's determination and found that petitioner had violated Rule 342(a). The Board of Directors censured petitioner and suspended him for a period of one week from employment or association in any supervisory capacity with any Exchange member or member organization. Pet. App. 22a-23a, 27a.

b. Petitioner applied to the Commission for review of the Board's decision. Based on an independent review of the record, the Commission sustained the disciplinary action imposed by the Exchange. Pet. App. 8a-21a. The Commission stated that "the firm had no management structure by which Keller was to be supervised, and [petitioner], as Keller's direct superior, conducted no supervision." *Id.* at 11a. The Commission held that, as Keller's direct superior, petitioner was responsible for ensuring that he received adequate supervision, but that petitioner failed to supervise Keller himself or to delegate responsibility for Keller's supervision. *Id.* at 11a-13a.

The Commission also rejected petitioner's assertion that he was denied due process because he was found to have violated Rule 342(a) by failing, as the firm's president, to establish adequate procedures and structures for Keller's supervision. Petitioner argued that such conduct could only be charged under clause (b) of

Rule 342.[3] The Commission concluded, however, that clause (a) of Rule 342 encompasses "not only the duties of direct supervisors, but the oversight duties of officials, including the president, who are in charge of employees and activities within the firm." Pet. App. 15a. The Commission reasoned that Rule 342(a) includes the general requirement that such officials properly supervise employees under their authority, and that a violation of Rule 342(a) can result from a variety of causes, including a failure by the officials to establish proper supervisory procedures and structures. Pet. App. 14a.

c. The court of appeals denied petitioner's petition for review. Pet. App. 1a-7a. The court agreed with the Commission that petitioner's conduct violated Rule 342(a) and that petitioner was not denied due process. Pet. App. 5a. The court concluded that Rule 342(a) imposes an obligation on each person in a firm's chain of command to supervise the activities of those employees that person oversees. Pet. App. 6a. Rejecting peti-

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[3] Rule 342(b) (*reprinted at* Pet. App. 38a), provides:

The general partners or directors of each member organization shall provide for appropriate supervisory control and shall designate a general partner or principal executive officer to assume overall authority and responsibility for internal supervision and control of the organization and compliance with securities laws and regulations. This person shall:

(1) delegate to qualified principals or employees responsibility and authority for supervision and control of each office, department or business activity, and provide for appropriate procedures of supervision and control.

(2) establish a separate system of follow-up and review to determine that the delegated authority and responsibility is being properly exercised.

tioner's contention that Rule 342(a) applies only to direct supervisors, the court pointed out that petitioner, as president, was in charge of all the firm's activities and employees. Pet. App. 6a. The court found that petitioner's failure as president to oversee the implementation of an adequate command structure that provided for Keller's supervision violated Rule 342(a). Pet. App. 6a. In addition, the court found that petitioner, as Keller's direct corporate superior, failed to satisfy his duty under Rule 342(a) to supervise Keller directly or to oversee his supervision by others. Pet. App. 6a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Petitioner errs in contending (Pet. 8-9) that Rule 342(a) did not impose an obligation on him to supervise Keller because petitioner had not been designated as Keller's supervisor. The court of appeals properly determined that petitioner, as Keller's direct corporate superior, violated Rule 342(a) by failing to discharge his responsibility for supervision of Keller's trading activities. Petitioner was in charge of Keller, a vice president immediately below petitioner in the chain of command. Petitioner concedes that he did not supervise Keller's activity or delegate that responsibility to anyone else at the firm. That conduct violated Rule 342(a)'s requirement that a person in charge of employees must reasonably discharge his or her supervisory responsibilities over those employees.

2. Contrary to petitioner's contention (Pet. 9), petitioner was not improperly found liable under Rule 342(a) for conduct that could be charged only under Rule

342(b). The fact that a failure to supervise under Rule 342(a) results from a failure to establish appropriate procedures for supervision, which might itself amount to a violation of Rule 342(b), does not remove the conduct from the ambit of Rule 342(a).[4] Moreover, petitioner's violation of Rule 342(a) was not based primarily on his failure to establish supervisory procedures for the firm's employees; rather, the primary basis of his liability was his failure, as Keller's direct superior, to supervise him or to delegate that responsibility. Pet. App. 15a.

3. Petitioner's claim (Pet. 7) that his due process rights were violated because he was found liable for wrongdoing that was never included in the charge against him is without merit. Petitioner was not, as he asserts, charged by the Exchange solely as Keller's designated supervisor. Petitioner's wrongdoing as Keller's direct corporate superior was included in the Exchange's charge and was addressed at the hearing. The Exchange's charge showed the corporate chain of command by identifying petitioner as president and Keller as vice president, stated that petitioner "was

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[4] It is not unusual for the same conduct to violate more than one statute or rule. See, *e.g.*, *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 468 (1969). Further, contrary to petitioner's assertion (Pet. 8), Exchange hearing panel decisions often describe Rule 342(a) violations as based on the failure of a brokerage firm president to provide appropriate procedures or systems of supervision, and they often make no reference to Rule 342(b). See, *e.g.*, *Arthur Howard Ross*, Exchange Hearing Panel Dec. No. 87-13 (Mar. 10, 1987), 1987 WL 225759 (NYSE) (FSEC-ALL Database). Where violations of both Rule 342(a) and Rule 342(b) are charged, the description of each violation frequently includes similar language with respect to a failure to assure adequate systems and procedures of supervision. See, *e.g.*, *Joseph A. Vitanza*, Exchange Hearing Panel Dec. No. 92-26 (Feb. 14, 1992), 1992 WL 300598 (NYSE) (FSEC-ALL Database).

responsible for supervision of Keller's trading in the [proprietary] Account," and alleged that petitioner "failed to take effective steps to prevent improper proprietary trading in the Account." Pet. App. 32a-33a. Thus, the Commission did not, as petitioner contends (Pet. 8), broaden the charge against him when it found him liable based on his responsibility as Keller's direct superior.

In addition, petitioner's wrongdoing as Keller's direct superior was addressed at the panel hearing. The testimony before the panel showed that petitioner was Keller's direct superior and that he nonetheless did not supervise Keller's activity or delegate that responsibility to anyone else at the firm. C.A. App. 2, 4, 62, 66, 86-87, 95. Even if petitioner did not have adequate notice that the charge encompassed his failure to supervise Keller as direct superior, any additional evidence that he might have adduced regarding Keller's supervision would have contradicted petitioner's own steadfast position that "nobody supervises Mr. Keller other than Mr. Keller."[5] *Id.* at 95.

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[5] Petitioner also argues that the charge did not encompass his failure, as the firm's president, to establish procedures and structures for Keller's supervision. Even though such failure was not the primary basis for petitioner's liability, the charge provided him with adequate notice. It identified petitioner as president of the firm and stated that he "failed to take effective steps to prevent improper proprietary trading in the Account." Pet. App. 32a-33a. Petitioner's failure to assure that the firm had adequate procedures for supervision of Keller's activities was also addressed at the hearing. Undisputed evidence in the record showed that the firm had no management structure providing for the supervision of Keller, that petitioner was responsible for internal supervision and control and for compliance with the securities laws, and that no one at the firm supervised Keller. C.A. App. 17, 19, 23, 62, 71-72, 95, 96-97, 103-104.

4. Finally, there is no basis for petitioner's assertion (Pet. 9-11) that the decision of the court of appeals is inconsistent with the statutory requirements for Commission review of disciplinary sanctions imposed by self-regulatory organizations. The court of appeals did not confuse the Commission's role as a reviewing body with its role as a prosecuting body.[6] This proceeding involved only the Commission's statutory responsibility to review disciplinary sanctions imposed by self-regulatory organizations. See 15 U.S.C. 78s(d) and (e). In reviewing such sanctions, the Commission is required to determine whether a person's conduct violated the securities laws and rules or the self-regulatory organization's rules. 15 U.S.C. 78s(e)(1)(A). In reviewing petitioner's case, the Commission necessarily interpreted how Rule 342(a) applied to his conduct. Performance of that role does not mean that the Commission went beyond its review role and legislated a new requirement not already contained within Rule 342(a).

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[6] There was also nothing improper in the court of appeals' reliance on two decisions in which the Commission enunciated the principle that the president of a broker-dealer "is responsible for compliance with all of the requirements imposed on his firm unless and until he reasonably delegates particular functions to another person in that firm, and neither knows nor has reason to know that such person's performance is deficient." *In re Kochcapital, Inc.*, Exchange Act Release No. 31,652 (Dec. 23, 1992), 53 S.E.C. Docket 361, 370 n.18; *In re Universal Heritage Inv. Corp.*, 47 S.E.C. 839, 845 (1982). Although those cases involved Commission review of sanctions imposed by the National Association of Securities Dealers, Inc., for breach of its rule on supervisory responsibilities (not, as petitioner asserts (Pet. 10), disciplinary action by the Commission), the principle applies to Exchange Rule 342(a) as well.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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